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No. 75-1718

In the Supreme Court of the United States

OCTOBER TERM, 1976

UNION PACIFIC RAILROAD COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The opinion of the Court of Claims (Pet. App. B 1-74) is reported at 524 F. 2d 1343. The court's findings of fact are set forth at Pet. App. B 74-244.

JURISDICTION

The opinion of the Court of Claims was issued on October 22, 1975, and a petition for rehearing was denied on February 27, 1976 (Pet. 1).[1] The petition for a writ of certiorari was filed on May 26, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTIONS PRESENTED

1. Whether for purposes of computing petitioner's excess profits tax credit under the World War II

[1] The judgment of the Court of Claims has not yet been computed pursuant to Rule 131(c) of its Rules.

Excess Profits Tax Act, the Court of Claims correctly determined that the fair market value of petitioner's common and preferred stock issued from 1898 through 1901 was $75,859,188, based on prices paid in contemporaneous sales on the New York Stock Exchange.

2. Whether petitioner's amortization of bond discount and expense, unamortized bond discount and expense for bonds reacquired, and call premiums paid to retire bonds constituted interest for purposes of computing its excess profits net income under Section 711(a)(2) of the Internal Revenue Code of 1939.

STATUTES INVOLVED

Sections 711, 714, and 718 of the Internal Revenue Code of 1939, pertaining to the World War II Excess Profits Tax Act, are set forth at pages 38-45 of the petition.

STATEMENT

Petitioner brought this suit in the Court of Claims for refund of World War II income and excess profits tax for the year 1942. The applicable tax statutes have been repealed as of December 31, 1945. See Section 122(a) of the Revenue Act of 1945, c. 453, 59 Stat. 556, 558.

The pertinent facts are as follows: Petitioner was incorporated in Utah in 1897 to acquire the assets of a bankrupt predecessor (Pet. App. B 127-128). A reorganization committee purchased the assets at a foreclosure sale and transferred them to petitioner for its bonds, 610,000 shares of its common stock, and 750,000 shares of its preferred stock, which were issued on January 31, 1898 (Pet. App. B 134-135). Thereafter, from January 26, 1899, to June 30, 1901, petitioner issued 273,343

shares of its common stock to acquire the common stock of the Oregon Short Line Railroad Company plus a $3 per share cash assessment paid by the Short Line stockholders (Pet. App. B 129).[2]

The first issue in this refund suit concerns the fair market value of petitioner's stock issued from 1898 through 1901. That value is the amount to be included in "equity invested capital" under Section 718 of the Internal Revenue Code of 1939. Equity invested capital, *i.e.*, the money and property paid in for the stock, is the starting point for computing the credit Section 714 allows with respect to invested capital in the determination of the amount of income subject to the World War II excess profits tax. The greater the value for equity invested capital, the greater the allowance credit.

The Commissioner of Internal Revenue originally valued the stock at $79.4 million. In this case, petitioner urged that the correct value was $251.7 million plus an additional $9.9 million representing cash contributions it received in the reorganization and in its acquisition of the Oregon Short Line Railroad. The government claimed the correct value was $57.5 million, an amount lower than the Commissioner's valuation (Pet. App. B 62-63, 131-132).

At trial, the parties presented expert testimony and other evidence as to the fair market value of this stock. The Court of Claims rejected the testimony of petitioner's expert witness because he valued the stock as of 1907, instead of as of the dates of issuance (Pet. App. B 140-141, 153-154). The court also rejected the conclusions of the government's expert witness (Pet. App. B 217-

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[2] From July 1, 1901, through June 30, 1908, petitioner issued an additional 150 shares of common stock for Short Line stock. However, the value of these shares is not at issue because the parties stipulated it to be $26,250 (Pet. App. B 129-130, 131).

218, 233-239), which were based on stock market values, net asset values, price-earnings ratios, capitalization of earnings, comparisons of petitioner's stock with that of other railroads, voting rights, and future prospects. In fixing a value, the court relied upon the various prices paid in contemporaneous sales of petitioner's stock on the New York Stock Exchange and arrived at an aggregate value for the stock of $75,859,188[3] (Pet. App. B 244).

The court valued the 750,000 shares of preferred stock issued on January 31, 1898, at $62.50 per share, the average price paid in sales on the New York Stock Exchange on February 2, 1898, the first day it was traded. Similarly, the court valued the 610,000 shares of petitioner's common stock issued on January 31, 1898, by computing the average price ($36) paid for Union Pacific trust receipts (which were exchangeable for one share of common and 15/100ths of a share of preferred) on the New York Stock Exchange on February 2, 1898, and subtracting from the $36 figure $9.375 ($62.50 times 15/100) for the market value of the preferred, thereby obtaining a market price of $26.625 per share of common stock. Finally, the court valued the 273,343 shares of petitioner's common stock issued from January 26, 1899, through June 30, 1901, for Short Line common stock and a cash assessment by dividing the stock issued into blocks and then utilizing the average price paid in sales of petitioner's common on the New York Stock Exchange during the period each block was issued (Pet. App. B 65-71).

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[3]This amount is equal to $75,885,438 (Pet. App. B 244) less $26,250 for the stipulated value of the last 150 shares issued. See n. 2, *supra*.

On its consolidated returns for 1940 and 1941 and its separate return for 1942, petitioner claimed deductions for amortization of bond discount and expense, unamortized bond discount and expense for bonds reacquired, and call premiums to retire bonds (Pet. App. B 108). In computing excess profits net income when the excess profits credit is computed under the invested capital method, Section 711(a)(2)(B) required that the deduction for interest be reduced to 50 percent of the interest on the indebtedness included in borrowed capital. The Court of Claims upheld the government's position that petitioner's discount and premium expenses were additional charges for the use of borrowed funds and were therefore interest, so that only 50 percent of these expenses could be deducted in computing the excess profits net income (Pet. App. B 46-52).

ARGUMENT

1. The Court of Claims correctly determined that the established New York Stock Exchange market value of petitioner's stock was the most reliable indication of its value for purposes of the World War II excess profits tax. The question relating to the valuation of the stock issued by petitioner in the period 1898 through 1901 is purely factual and does not warrant further review.

Although petitioner contends (Pet. 9-17) that there are 12 conclusions of the Court of Claims that are contradicted by its findings of fact, an analysis of petitioner's specific points fails to establish any significant variance between the findings and conclusions. Thus, for example, the fact (Pet. 10) that the Court of Claims' valuation of petitioner's common stock was less than that of the government's witness simply means that it rejected his testimony with respect to some of the stock. Similarly, there is no contradiction (Pet. 12) between the court's finding (Pet. App. B 219) that net assets and capitalization

of past earnings are not "legitimate starting points" in determining value and its conclusion that such net asset values can be used to substantiate values based upon contemporaneous market prices (Pet. App. B 69).

Furthermore, the court's findings with respect to future earnings prospects (Pet. 13-14) are in no way inconsistent with its rejection of petitioner's "reconstitutive-reorganization" theory, which the court found to be based upon an improper hindsight reliance upon 1907 values (Pet. App. B 141-153).[4]

Finally, contrary to petitioner's argument (Pet. 27-28), the fact that the Court of Claims rejected the valuation of the government's witness did not require it to accept all of the views of petitioner's expert. In valuation matters, a court is not required to choose between experts nor is it bound by the testimony of any particular expert witness. Rather, it is free to base its decision upon whatever evidence in the record it finds persuasive, regardless of its source. See *Toronto, Hamilton & Buffalo Nav. Co.* v. *United States*, 88 F. Supp. 1016, 1022 (Ct. Cl.); *In re Williams' Estate*, 256 F. 2d 217 (C.A. 9); *Logan Lumber Co.* v. *Commissioner*, 365 F. 2d 846 (C.A. 5); *Head* v. *Hargrave*, 105 U.S. 45; *The Conqueror*, 166 U.S. 110, 130-133; *Dayton P. & L. Co.* v. *Commissioner*, 292 U.S. 290, 299; *Sartor* v. *Arkansas Gas Corp.*, 321 U.S. 620, 627-628.

2. Petitioner further complains (Pet. 17-19) that the Court of Claims arrived at certain conclusions in its

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[4]Petitioner argues (Pet. 25-27) that the Court of Claims erred in determining that its expert witness valued the stock in question as of 1907. But in both its findings (Pet. App. B 140-141) and in its opinion (Pet. App. B 63), the court carefully analyzed the testimony of petitioner's expert and correctly concluded that what he had in fact done was to value the stock on the basis of hindsight use of 1907 market prices.

opinion for which it made no separate findings of fact. But there is no authority requiring such a duplication of effort where, as here, some of the court's findings of fact support more than one of its conclusions of law. See Rule 147(a), Rules of the United States Court of Claims; Rule 52(a), Fed. R. Civ. P., and *Brown & Williamson T. Corp.* v. *First National Bank of Blue Island*, 504 F. 2d 998, 1001, n. 2 (C.A. 7). Petitioner's reliance (Pet. 8-9, 17) on *United States* v. *Causby*, 328 U.S. 256, 267-268, is misplaced, because the then applicable statutory requirement that the Court of Claims make findings of fact on every material issue (Act of May 22, 1939, c. 140, 53 Stat. 752, amending 28 U.S.C. (1940 ed.) 288) was deleted in the 1948 revision of Title 28. See 28 U.S.C. 1255.

3. Petitioner also argues (Pet. 19-21) that it was unfairly surprised by the government's contention that the value of its stock should be based on prices paid in contemporaneous sales on the New York Stock Exchange and that, had it been aware of this contention, it would have tried the case differently. Apart from the fact that the applicable Treasury Regulations indicate that fair market value is established market value,[5] the government's *pretrial* submission of February 4, 1969, stated as follows (p. 5):

> 11. In general, the price at which a stock is sold in extensive trading near the valuation date is

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[5]Treasury Regulations 112 (1939 Code), Section 35.718-1, provide in part that

> If the basis to the taxpayer is cost and stock was issued for the property, the cost is the fair market value of such stock at the time of its issuance. *If the stock had no established market value at the time of the exchange*, the fair market value of the assets of the company at that time should be determined and the liabilities deducted. The resulting net

strong evidence of its fair market value. *American Steel Foundries* v. *United States*, 153 Ct. Cl. 234, 236 (1961); *Tennessee Products Corp.* v. *United States*, *supra* [124 Ct. Cl. 1, 107 F. Supp. 578 (1952)], pp. 18-19; *Hazeltine Corp* v. *Commissioner*, 89 F. 2d 513, 519 (C.A. 3d, 1937); *Rogers* v. *Helvering*, 107 F. 2d 394, 396 (C.A. 2d, 1939); *Western Maryland Railway Co.* v. *United States*, 131 F. Supp. 873, 890-892 (Md., 1955), affirmed *per curiam*, 227 F. 2d 576, certiorari denied, 351 U.S. 907.

There is accordingly no basis to petitioner's claim of surprise.

With respect to the merits of the valuation determination, petitioner argues (Pet. 21) that the Court of Claims erroneously concluded that stock market prices are determinative of fair market value as a matter of law. But the court did not so hold. It stated categorically (Pet. App. B 64) that valuation of assets requires a factual determination on the basis of all the evidence. In so holding, it adhered to its previous decision in *Bankers Trust Co.* v. *United States*, 518 F. 2d 1210, certiorari denied, No. 75-922, March 22, 1976, that where stock is freely traded on a stock exchange, quotations for the valuation date generally provide the best evidence of value, in the absence of special facts that might warrant rejection of the market prices.

Although petitioner cites (Pet. 22-23) five factors which it urges warrant rejection of market prices for valuing the reorganization stock, the court considered and rejected on the particular facts of this case (Pet. App. B 66-69) four of these factors: blockage, pessimism of investors,

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worth will be deemed to represent the total value of the outstanding stock. * * * [Emphasis added.]

use of prices on a particular day, and changes resulting from the reorganization. Finally, contrary to petitioner's argument, the court did take into account the remaining factor (use of prices for the common stock derived from market prices for the trust receipts) in deriving the February 2, 1898 value from the prices of the reorganization common which was not traded until February 25, 1898 (Pet. App. B 67-68).

4. Petitioner challenges (Pet. 28-30) the ruling that bond discount is interest on the ground that the Court of Claims erroneously relied upon precedent not formulated by this Court until 1965, or as late as 1974. In petitioner's view, a court should disregard all decisions rendered after the tax year in suit, notwithstanding the principle of *stare decisis*. But the nature of interest has not changed over the years. Thus, the Court of Claims properly relied upon decisions of this Court that resolved the status of payments resembling interest. Indeed, the principal precedent relied upon by the Court of Claims (Pet. App. B 47), *United States* v. *Midland-Ross Corp.*, 381 U.S. 54, was decided under the 1939 Code, which governs this case as well.

Petitioner finally contends (Pet. 33-34) that the Court of Claims failed to comment upon two sentences in the legislative history of the Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137. But the views of a subsequent Congress form a hazardous basis for ascertaining the intent of an earlier one (*United States* v. *Price*, 361 U.S. 304, 313; *United States* v. *Philadelphia Nat. Bank*, 374 U.S. 321, 348-349; *Waterman S.S. Corp.* v. *United States*, 381 U.S. 252, 269; *United States* v. *Southwestern Cable Co.*, 392 U.S. 157, 170).

At all events, the excerpt quoted by petitioner sheds no light on the scope of Section 711(a)(2)(B) because

it states that, under the World War II excess profits tax, the elimination of deductions arising out of retirement of debt at a premium was required only in computing base period net income. However, Section 711(a)(2)(B) did not eliminate any deduction; it reduced by half the otherwise allowable deduction for interest. Thus, if the excerpt has any significance, it is in the construction of Section 711(b)(1)(D), which is not at issue in this case.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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